

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter **of** the Appeal of)
DEJAY PRODUCTS, INC.) No. **84A-34**

For Appellant: Virgil L. Holt
General Manager

For Respondent: Alison M. Clark
Counsel

O P I N I O N

This appeal is made pursuant to section **25666^{1/}** of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Dejay Products, Inc., against a proposed assessment of additional franchise tax in the amount of \$7,330 for the income year 1980.

^{1/} Unless otherwise specified, all section references **are** to sections of the Revenue and Taxation Code as in effect for the income year in issue.

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The issue presented in this appeal is whether appellant is entitled to a bad debt deduction for the income year 1980, for the amount owed by Cederquist, Inc.

Appellant is a California corporation engaged in the manufacture of architectural ornamentation and special effects. During 1980, appellant entered into a contract for the sale of goods with Cederquist, Inc., for the amount of \$191,321. On November 24, 1980, Cederquist issued appellant a check for \$60,000. -This check was returned to appellant by the bank as Cederquist had requested a **stop** payment. A meeting of Cederquist creditors was held on March 12, 1981, to review the operating status of the business and to hear proposals on the most favorable disposition of creditors' claims. At this point Cederquist was experiencing a cash flow problem because it was not being paid approximately **\$1,800,000** owed to it by **the Golden Nugget Hotel and Casino**. A settlement of between \$300,000 and \$500,000 was expected.

Because of its cash flow problem, Cederquist, on March 31, 1981, filed for protection under chapter 11 of the Federal Bankruptcy Act. Cederquist began action against the Golden Nugget Hotel and Casino in **January** of 1982.. At this time, the operating reports filed with the bankruptcy court indicated that Cederquist was operating at a break-even or moderate profit level. Finally, in 1983, it was agreed that Cederquist would pay appellant the sum of \$18,600 as total compensation for the original debt of \$191,321. The bankruptcy court approved appellant's claim for \$62,000; however, only 30 percent, **or** \$18,600, was recoverable. Payments were made to appellant **over** a period of time and by March of 1984, appellant had received \$4,960 of the total amount awarded.

Appellant, on its 1980 corporate franchise tax return, took a bad debt deduction in the amount of \$131,321. Appellant arrived at this amount by anticipating that Cederquist would fail to pay its entire debt and would pay only \$60,000 of the total debt of \$191,321. Respondent denied appellant's bad debt deduction on the basis that appellant failed to establish that the debt became worthless in the year claimed. Appellant filed a timely appeal,

Section 24348, subdivision (a), provides that a corporate taxpayer may deduct all debts which become worthless within the income year. Deductions, however, are a matter of legislative grace and the burden is on

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appellant to prove that it is entitled to such deduction,'
(New Colonial Ice Co. v. Helvering, 292 U.S. 435 [78
L.Ed. 1348] (1934); Mayes v. Commissioner, 21 T.C. 286
(1953).)

Initially, we note that section 24348 is sub-
stantially identical to section 166 of the Internal
Revenue Code of 1954. Accordingly, federal case law is
highly persuasive in interpreting the California statute.
(Rihn v. Franchise Tax Board, 131 Cal.App.2d.356, 360
[280 P.2d 893] (1955).)

In order to be entitled to a deduction for a
bad debt, appellant must demonstrate that the debt became
totally worthless during the income year. Whether a debt
is totally worthless within a particular year is a
question of fact. (Perry v. Commissioner, 22 T.C. 968
(1954); Mellen v. Commissioner, ¶ 68,094 T.C.M. (P-B)
(1968).) The burden is on appellant to prove that the
debt for which the deduction is claimed had some value at
the beginning of the year in which the deduction is
claimed, and that it became worthless during that year.
(Cittadini v. Commissioner, 139 F.2d 29 (4th Cir. 1943);
Appeal of Knollwood West Convalescent Hospitals, Inc.,
Cal. St. Bd. of Equal., Mar. 3, 1982.) The standard for
the determination of worthlessness is an objective test
of actual worthlessness.. (Appeal of Parabam, Inc., Cal.
St. Bd. of Equal., June 29, 1982.) The time for worth-
lessness must be fixed by an identifiable event or events
in the period in which the deduction is claimed which
furnish a reasonable basis for abandoning any hope of
future recovery. (United States v. White Dental Mfg.
Co., 274 U.S. 398 (71 L.Ed. 11203 (1927); Appeal of B & C
Welding, Inc., Cal. St. Bd. of Equal., Oct. 26, 1983.)

Appellant appears to contend that once Cederquist
stopped payment on the \$60,000 check issued in November
of 1980, the debt became worthless. We cannot agree.
Mere nonpayment of a debt does not prove its worthlessness.
(Appeal of Jordan Associates, Inc., etc., Cal. St.
Bd. of Equal., Apr. 24, 1967.) The existing evidence,
rather, shows that Cederquist did not file a petition in
the bankruptcy court until March of 1981. At that time,
Cederquist was owed \$1,800,000 from one of its clients
and, at the least, expected a \$300,000 to \$500,000
settlement on the debt. As late as January of 1982,
Cederquist was reported to be operating at a break-even
or moderate profit level. In sum, the evidence does not
support a finding that any of the debt was worthless at
the end of 1980. There is, in fact, evidence to support

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a finding that the debt did not become even partially worthless. until 1983 when the bankruptcy court approved **appellant's claim** for 30 percent of \$62,000 or \$18,600.

Accordingly, we conclude that respondent did not err in disallowing the bad debt deduction for the income year **1980**.

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O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Dejay Products, Inc., against a proposed assessment of additional franchise tax in the amount of \$7,330 for the income year 1980, be **and** the same is hereby sustained.

Done at Sacramento, California, this 20th day of August , 1985, by the State Board of Equalization, with Board **Members** Mr. Collis, Mr. Nevins and Mr. Harvey present.

_____	Chairman
Conway H. Collis	, Member
Richard Nevins	, Member
Walter Harvey*	- Member
_____	Member

*For Kenneth Cory, per Government Code section 7.9